

Investigation by the Department of Telecommunications and Energy on its own Motion into the Provision of Default Service))))))	D.T.E. 02-40
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customer behavior regarding the consumption of electricity in the wholesale and retail markets.

In this regard, load response can play an important role in a competitive marketplace by allowing customers to respond to price signals. In D.T.E. 02-38, the Department recognized the potential distributed generation has for load response programs, and therefore, the ISO respectfully submits that the Department should recognize the interrelated nature of these two Dockets.

II. Introduction

ISO New England Inc. (the “ISO”) is the private, non-profit Independent System Operator for New England. Pursuant to the ISO Agreement, the ISO administers the NEPOOL product markets, and operates the New England bulk power system pursuant to the Interim Independent System Operator Agreement between the ISO and the NEPOOL Participants, the Restated NEPOOL Agreement, and the New England Power Pool Open Access Transmission Tariff (“NOATT”). The ISO has the responsibility to protect the short-term reliability of the control area, to administer competitive and efficient wholesale markets and to administer the NOATT on behalf of the NEPOOL Participants.

III. Background to the Investigation in D.T.E. 02-40

On June 21, 2002, the Massachusetts Department of Telecommunications and Energy (“Department”) opened an investigation on its own motion into “all aspects of the manner in which default service is provided to ensure that it is compatible with the development of an efficient competitive market.” See D.T.E. 02-40 at 1; see also id. at 4. As the Department noted, “[b]y opening this investigation now, [the Department] can

best ensure that the benefits of a competitive market are available to all Massachusetts consumers at the end of the standard offer service transition period.” Id. at 1.

In its June 21, 2002, notice, the Department stated that its objective in opening this investigation “is to ensure that the manner in which default service is provided is compatible with the development of an efficient competitive market in Massachusetts.”

Id. The ISO shares the Department’s objective and believes that an efficient and competitive retail market will help maintain a healthy and efficient wholesale electricity market. The establishment of reliable and efficient wholesale electricity markets in New England is a central mission to the ISO.

In opening this investigation, the Department noted three broad issues that it would evaluate. They are:

- (1) The role of distribution companies as providers of last resort, id. at 4, 6;
- (2) Identification of those features of default service that may impede or deter consumers’ resort to the competitive market, id. at 5; and
- (3) How default service may be provided in the context of a competitive electric industry, id. at 6.

The ISO respectfully provides comments to these issues herein, and looks forward to providing more substantial supplemental comments in this Docket. In addition, the ISO respectfully submits that the Department’s investigation should include consideration of the relationship between the wholesale electricity market and the role and potential of distributed generation and demand response in Massachusetts.

IV. Wholesale Electricity Market Design and Retail Market Design are Interrelated.

The New England wholesale electricity market is designed to balance the supply (provided by electric generators) and demand for electricity (including both wholesale and retail customers). Like any other market system, this balance is achieved through price signals that provide incentives that result in responses by market participants to either increase supply or reduce demand.

The incentives in the market system thus allow industry participants to meet the energy needs of consumers in an efficient manner. For this balance to take place and for efficient price signals to be sent, however, the market must operate fairly, competitively and efficiently. Our experience to date has shown that new generators and the operators of existing generators have responded appropriately to market incentives.

In 2003, the New England Power Pool (“NEPOOL”) is transitioning to Standard Market Design (“SMD”). Moreover, on July 31, 2002, the Federal Energy Regulatory Commission issued its notice of proposed rulemaking on “Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design.” These initiatives may have impacts on retail market design, and likewise, retail market design could impact these initiatives.

SMD will introduce locational marginal pricing (“LMP”). LMP sends price signals that show where the delivery of energy is constrained by the transmission system. These delivery constraints are likely to result in higher prices in regions that have a limited ability to import power and lower prices in regions with limited power export capability. LMP, combined with retail rates such as time of use seasonal rates that also

provide customers with signals regarding the true costs of energy consumption, should increase the incentives for demand response in the wholesale and retail electric market.

In this regard, competitive suppliers could offer value-added services to their customers by working with them to reduce consumption during hours when energy costs are high. Expecting competitive suppliers to provide such services presumes, however, that the competitive suppliers have the opportunity to differentiate themselves and that they know which customers they are supplying. In short, if the competitive supplier is only supplying a percentage of a customer class (without specific customer assignment), then there is little or no incentive for the supplier to help a customer reduce consumption, because the supplier only receives a percentage of the customer reduction, rather than the entire reduction that is attributable to its efforts.

Moreover, for price signals to have their intended effect, the costs of default service should reflect its true costs so as to allow fair competition to occur. If retail service is not formulated and priced correctly, new suppliers will not enter the market and a competitive market will not develop. For example, if the charge for default service is set artificially below the average cost of energy on the wholesale market or does not reflect all the costs of serving and acquiring load, it could be difficult for new suppliers to enter the retail market and compete with the local distribution company for those customers.

A healthy wholesale energy market is linked to a strong and competitive retail energy market. Without retail customers responding to price signals, the wholesale market may not function properly. Retail customers responding to high-energy prices by reducing their demand can help to temper wholesale energy prices. The reaction to

energy prices transforms what might be inelastic demand into demand that is willing and able to curtail consumption if the price becomes too high. This linkage makes the pricing of retail service important to the wholesale market.

V. The Department’s Investigation into the Role Distributed Generation and Load Response Can Play in a Restructured Electric Industry in D.T.E. 02-38 is Related to this Proceeding.

The standard offer in Massachusetts is scheduled to end in February 2005, and its conclusion is likely to increase the number of customers on default service. It is important therefore to design default service so that it provides the proper incentives for distributed generation, as well as other demand side options.

In opening its investigation on distributed generation, the Department explained that it has “recognized the importance of distributed generation as a resource option in the restructured electric industry.” See D.T.E. 02-38 at 1. The Department also recognized that “distributed generation can meet customers’ energy needs [and that] [i]t also has the potential for load response.” Id.

ISO agrees with the Department’s recognition of the potential that load response can play and believes that load response can assist in providing a healthy competitive marketplace. Because distributed generation is a way for demand to respond to price, ISO respectfully submits that the Department should recognize and consider the relationship between its policies concerning distributed generation, a competitive wholesale marketplace and a competitive retail marketplace.

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The ISO commends the Department on its attention to these issues and hopes that the ISO’s comments regarding the relationship between wholesale market operation and

policies and retail market design prove useful to the Department. As stated above, ISO expects to file additional and more substantial supplemental comments in this Docket.